sasfin beyond a bank

The Daily Market

05 August 2022

USD-ZAR	16,605/16,6275	**GBP-ZAR**	20,1693/20,1933
GBP-USD	1,2145/1,2196	**AUD-USD**	0,6966/0,6972
GOLD	$1791,4308	**DJI**	44777,00
EUR-ZAR	16,9987/17,0142	**EUR-USD**	1,0231/1,0235
USD-JPY	133,24/133,25	**R 186**	8,815%
BRENT	$94,52	**3m JIBAR**	5,725

Events (GMT)

09:00	SA	ILB auction (R1.2bn)			
06:00	GE	Industrial production wda y/y	Jun	-1,2%	-1,5%
11:15	UK	BOE's Huw Pill speaks			
12:30	US	Change in nonfarm payrolls	Jul	250k	372k
12:30	US	Unemployment rate	Jul	3,6%	3,6%
19:00	US	Consumer credit	Jun	$25bn	$22,35bn

Factors on the radar

China – Taiwan

What happened?	Tensions continue to run high, with Taiwan condemning their “evil neighbour” as China continued firing missiles into surrounding waters with some missiles flying overhead
Relevance	Airlines have halted flights to the region, and the waterway will not be used while such military drills are undertaken
Importance	5/5 (geopolitics)
Analysis	China’s strong arm and bullying tactics have been condemned worldwide. China maintains its “one-China” policy and has made it clear that it seeks reunification. Taiwan sees itself as an independent sovereign

US Payrolls

What happened?	All eyes will be on the non-farm payroll data later today. While the labour market remains tight, any sign of weakness will prompt a reassessment of the rate outlook
Relevance	How shallow the downturn will depend in part on how well the labour market holds up
Importance	4/5 (monetary policy)
Analysis	Any sign of weakness and the USD will likely correct as bond yields continue sliding. This will be an important driver of markets, if not today, then in future publications

Ukraine exports

What happened?	Three more grain ships with a total of more than 58k tonnes of grain are scheduled to leave Ukrainian ports on Friday as part of a deal to unlock exports
Relevance	At the margin, this will help reduce grain prices and ease some of the food inflation pressures
Importance	4/5 (markets)
Analysis	Although it is unclear whether the exports will continue long-term, this is welcome news and will help reverse or at least stall the rise in commodity and food prices slightly

Today’s Talking Point

US Change in nonfarm payrolls: Jul

Expected: 250k

Prior: 372k

Analysis: The June jobs data came in stronger than expected, confirming that the US labour market remains tight. More jobs were added than forecast while the unemployment rate held near a five-decade low, providing signs of strong demand that supports the Federal Reserve’s aggressive policy stance. After last week’s 75bp rate, investors will eagerly anticipate the July jobs report as it will help guide the future path of the Fed. A stronger than expected number could further embolden the Fed, while a soft number could signal that policy tightening is starting to weigh on employment, particularly in interest rate-sensitive sectors, adding to growth concerns. If recent jobless claims figures are anything to go by, the risk to this release is to the downside.

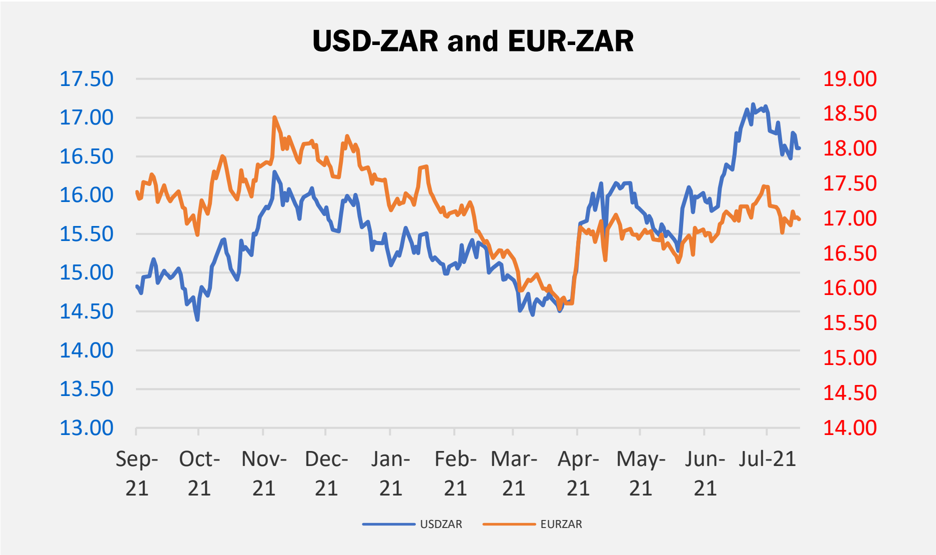
Rand Update

Another strong day on the ZAR, and it could end relatively flat after a relatively volatile week. The core driver yesterday in the ZAR’s appreciation was the retreat in the USD. Debates are raging around whether the USD will enjoy one last leg higher, or whether there is so much priced into the USD that the risks sit overwhelmingly in favour of a retreat. On the one hand, majors such as the EUR and the GBP face unprecedented geopolitical and growth risks that must be priced for. On the other, the USD is already fully priced. All other central banks are also hiking rates, with the BoE and the RBA both hiking by the strongest amounts in decades.

As we head into what will turn into a long weekend in South Africa, some traders will look to close out positions that were most likely long USD positions. There also seems to be some decent demand returning for SA bonds as investors look through the current spike in inflation and rates to the slowdown that will inevitably follow. The outlook for the ZAR remains constructive. It enjoys healthy carry attractiveness and is no more economically fragile than many other countries, while ETM’s ZAR Sentiment Indicator has spiked to point to a phase of ZAR appreciation. Whether that is a function of local factors or a weaker USD is not clear, but it will most likely be a combination of both.

Domestically, there is not much to focus on other than the usual political noise, which means that much of the focus will turn to the US non-farm payrolls data as investors try to gauge the strength of the underlying US economy. Any sign of weakness will likely count heavily against the USD, although it may still be too soon for that weakness to have manifested.

Nonetheless, with so much priced into the USD, it remains vulnerable, and exporters are encouraged to view current levels as offering decent value over the next 6-12 months. Importers may need to be patient and wait for the market t unwind some of its long USD positionings in order for greater value to be extracted.

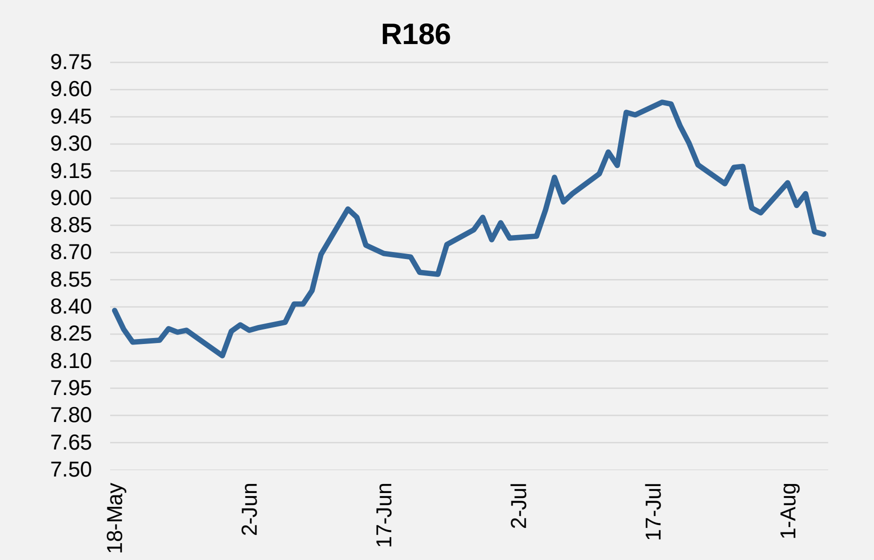


Bond Update

The Bank of England delivered a 50bp rate hike yesterday with the promise of further tightening in the months ahead. Concerningly, the BoE warned that a recession will begin in the final quarter of the year and last all the way through 2023. That would be the longest slump since the financial crisis, with officials expecting the economy to shrink by around 2.1% in total. Meanwhile, the inflation peak was revised higher to 13% in October amid a surge in gas prices and the bank warned that price gains will remain elevated throughout 2023. It is, therefore, fair to say that the core market remains in an environment of tightening monetary policy yet rising recession risk.

This will keep capital availability to EMs like South Africa constrained, with cross-currency basis swaps (a derivative instrument that reverses the effect of currency and interest rate changes) inverted in the 5y+ portion of the curve to suggest that longer-term financing is coming at a high cost to SA. Global recession favours an allocation into bonds rather than equities, which seems to be supporting a rally in the domestic market. Despite an upbeat "whole economy" PMI that was released this week, a similar outlook can be painted for SA when considering that household incomes remain constrained by the weak economy. Investors continue to price in a weak retail sector outlook, with the recent Massmart earnings result and outlook reflecting an environment of constrained consumer budgets.

Falling oil prices and some ZAR strength meanwhile seem to be supporting receiving interest in the FRA market, which suggests that the market is speculating that the SARB will be hard pressed to raise rates aggressively in the months ahead. The 21x24 FRA rate has compressed to 7.73% in overnight pricing, down nearly 100bp from recent peaks.



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